

*United States Court of Appeals
for the Second Circuit*



**APPELLANT'S
BRIEF**

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UNITED STATES COURT OF APPEALS
SECOND CIRCUIT-----X

IN THE MATTER

OF

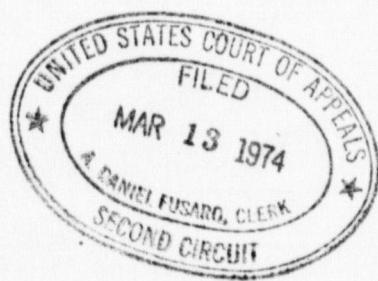
UNISHOPS, INC.,

Debtor

In Proceedings for an
Arrangement No. 73-B-1208
Docket No. 74-1309

APPELLANTS' MEMORANDUM

OF LAW



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PRELIMINARY STATEMENT

This is an appeal by the debtor and debtor in possession from an order of Judge Charles Brieant, Jr., dated March 4, 1974, affirming an order of Judge Roy Babitt, dated February 6, 1974, denying the application of the debtor and debtor in possession for an order restraining and enjoining suits against the creditors or persons who assert themselves to be creditors of subsidiaries or subsubsidiaries of the debtor and debtor in possession.

STATEMENT OF FACTS

The basic facts in support of the position of the debtor and debtor in possession are set forth in their original application dated December 12, 1973, based upon which Bankruptcy Judge Babitt entered an order to show cause with temporary restraining order on December 13, 1973,

which application is annexed, as Exhibit A, to the order to show cause signed by Hon. Walter Mansfield of this court on March 8, 1974. Said original application came on for hearing before Bankruptcy Judge Babitt on November 27, 1973, and was adjourned, with the temporary stay continued, to January 7, 1974. At the latter hearing argument of counsel was heard by Judge Babitt in connection with the application of the debtor and debtor in possession for an adjournment in order to prepare the case properly for trial and for the continuance until trial of the temporary stay. At the conclusion of such argument, Judge Babitt adjourned the matter to February 6, 1974, and set aside the entire day and the entire day of February 7, 1974 for the taking of testimony and the presenting of evidence. Judge Babitt continued the stay in full force and effect until then.

On the trial date, February 6, 1974, the debtor and debtor in possession appeared with counsel and several witnesses and considerable documentation and were prepared to proceed to adduce testimony and present evidence in support of the allegations contained in the application of December 12, 1973. However, at the outset of the hearing, Judge Babitt stated that he believed that the Bankruptcy Court lacked jurisdiction to consider the application for a stay, and oral argument of counsel on the jurisdictional issue ensued. The question of jurisdiction had been raised

and argued at the prior hearings of December 27 and January 7; and the court then felt that, since it had jurisdiction to determine its own jurisdiction, a decision on this issue should be held in abeyance until after the taking of proof. However, Judge Babitt then rendered his decision on the record and endorsed an order (which is the order herein appealed from) on the moving papers denying the application of the debtor and debtor in possession on the ground that the court lacked jurisdiction. He further stated that in his opinion no evidentiary hearing was required since he was denying the application as a matter of law, and even assuming the truth of applicants' allegations and casting them in their most favorable light, he was still without jurisdiction.

After considerable oral argument, Judge Babitt granted a stay pending appeal on the conditions set forth in the record. The parties present in court agreed that the record on appeal was to consist of merely the moving papers and the minutes of the hearing of February 6, 1974 and that the appeal would be expedited.

On February 28, 1974, the parties appeared before Hon. Charles L. Brieant, Jr., on an appeal from Judge Babitt's order. After considerable oral argument, Judge Brieant reserved decision on the appeal and continued a modified stay.

On March 4, 1974, Judge Brieant issued a memorandum opinion and order affirming Judge Babitt's decision, but continuing the limited stay imposed in court on February 28, 1974 for an additional 10 days in order that the debtor in possession may file an appeal.

On March 8, 1974, the debtor in possession filed a notice of appeal from Judge Brieant's decision and on the same day, the instant order to show cause was signed by the Hon. Walter R. Mansfield of this court.

QUESTIONS PRESENTED

1. Whether the Bankruptcy and District Court Judges erred in deciding as a matter of law that they lacked jurisdiction to consider the application of the debtor and debtor in possession for a stay.
2. Whether the Bankruptcy Judge erred in not conducting an evidentiary hearing to enable him to determine whether to exercise his jurisdiction and grant the application of the debtor and debtor in possession for a stay.
3. Whether this matter should be remanded to the Bankruptcy Judge for an evidentiary hearing, with the temporary stay continued in effect pending such hearing and final determination.

POINT I

THE BANKRUPTCY AND DISTRICT COURT JUDGES ERRED IN DECIDING AS A MATTER OF LAW THAT THEY LACKED JURISDICTION TO CONSIDER THE APPLICATION OF THE DEBTOR AND DEBTOR IN POSSESSION FOR A STAY.

Judges Babitt and Brieant bottomed their decisions on two cases: In re: Adolf Gobel, Inc., 80 F (2d) 849 (2d Cir.) 1936 and In re: Beck Industries Inc., 479 F (2d) 410 (2d Cir.) 1973. Appellants contend that such cases are inapposite and totally distinguishable from the case at bar. This memorandum will be devoted to explaining this position, since it is the crux of the within appeal.

The court in Gobel was concerned with an action by a creditor of a wholly owned subsidiary of the reorganization debtor. This underlines the threshold question that appellants emphasized before the Bankruptcy and District Court Judges: namely, that the suits which have been commenced and those which have been threatened against the subsidiaries are by persons who are creditors of the debtor herein, not such subsidiaries. Appellants, therefore, distinguish Gobel at the outset on the ground that we are not concerned here with suits by creditors who are creditors of subsidiaries.

Moreover, in Gobel, the subsidiary was "independently managed before and after the debtor's acquisition of the common stock . . . Solvent and doing a profitable

business, it was in no way involved in the debtor's proceeding for reorganization." Id. at 850-51. In the case at bar, not all of the debtor's subsidiaries are solvent or profitable, and more importantly the debtor and its subsidiaries operate as a chain on a consolidated basis and the affairs of the subsidiaries are inter-related with those of its debtor-parent and all executive control emanates from the debtor-parent. The subsidiaries in the case at bar are not the wholly independent type that existed in Gobel.

Judge Babitt determined and Judge Brieant affirmed that an evidentiary hearing was not necessary, and Judge Babitt assumed as true all allegations in the application of the debtor in possession. It is submitted that those allegations alone are sufficient to take this case out of the Gobel ruling. Moreover, an evidentiary hearing if held would have buttressed those allegations with substantial evidence of a documentary nature and oral testimony by persons with first-hand knowledge as to how the debtor's subsidiaries functioned so as to constitute vendors as creditors of the parent, not the subsidiaries. By depriving appellants of such evidentiary hearing, the Bankruptcy and District Court Judges deprived themselves of the basis upon which their jurisdiction is bottomed, and such hearing would have demonstrated the reasons that compel the

exercise of the Bankruptcy Court's discretion to use its unquestioned injunctive power.

The Beck case, supra, is likewise distinguishable. This Court in Beck emphasized that the lower courts found that assets of the subsidiaries were property of the estate of the reorganization debtor. The debtor's argument is in essence that all inventories have been and are its property (and never were property of subsidiaries) and a fortiorari those who sold that inventory are creditors of the debtor herein, not its subsidiaries. The debtor seeks a declaratory judgment of the foregoing facts, which will eliminate the basic ingredient which compelled the Gobel and Beck courts to decide as they did, by reaching a determination that we are not here concerned with a creditor of a subsidiary.

Moreover, in Beck, nothing in the record pertaining to the subsidiary exists. The subsidiary in Beck traded in its own name, had its own assets, creditors and debts and "consistently held itself out to the general public and trade creditors as a business separate and distinct from Beck." Id at 417. This Court further noted in Beck that there was no evidence that the subsidiary's sources of business were in any way dependent upon those of the parent or that the conduct of its affairs indicated a corporate existence dependent upon and related to the parent. The facts in Beck are not the facts here, but the Bankruptcy

and District Court Judges did not distinguish the facts alleged notwithstanding that they assumed them to be true.

In Beck, the parent set up the subsidiary in question for the special and limited purpose of the transaction involved. This Court criticized Beck for wanting it both ways; however, in the case at bar appellants and their subsidiaries constructed the mode of dealing with the vendors consistent with their obligations to institutional lenders and intentionally contoured their relations with the trade so as to render the debtor-parent liable, not subsidiaries.

The Beck and Gobel cases do not govern or control the decision here and the Judges erred in finding that they did.

POINT II

THE BANKRUPTCY JUDGE ERRED IN NOT CONDUCTING AN EVIDENTIARY HEARING TO ENABLE HIM TO DETERMINE WHETHER TO EXERCISE HIS JURISDICTION AND GRANT THE APPLICATION OF THE DEBTOR AND DEBTOR IN POSSESSION FOR A STAY.

As noted in Point I of this memorandum, the Bankruptcy Judge assumed the allegations in the application of December 12, 1973 to be true. It is submitted that these allegations alone take this case outside of Beck and Gobel. However, the Bankruptcy Judge declined to accept testimony

and receive evidence, all of which were available for presentation at the scheduled trial and which would have established in the main that the vendors sold to the debtor and are creditors of the debtor alone. Moreover, the inter-related operations of parent and subsidiaries and subsubsidiaries would have been demonstrated, further to remove this case from Gobel and Beck. In not conducting an evidentiary hearing, it is respectfully submitted that the Bankruptcy and District Court Judges erred; and their reliance upon Beck and Gobel was misplaced, for the issues here cannot be decided as a matter of law. It is submitted that that is the lesson of Beck and Gobel, for the facts in each case will surely determine whether suits against subsidiaries should be stayed.

POINT III

THIS MATTER SHOULD BE REMANDED TO THE BANKRUPTCY JUDGE FOR AN EVIDENTIARY HEARING, WITH THE TEMPORARY STAY CONTINUED IN EFFECT PENDING SUCH HEARING AND FINAL DETERMINATION.

As indicated above in this memorandum, it is necessary that an evidentiary hearing be held. There can be no dispute that based upon the manner in which the debtor and its subsidiaries have conducted business that all inventory wheresoever located is property of the debtor over which the Bankruptcy Court has exclusive jurisdiction. This premise coupled with the facts that an evidentiary hearing

would establish provide further differences between this case and both Beck and Gobel. To permit the commencement of a plethora of lawsuits against the subsidiaries and sub-subsidiaries in many jurisdictions at this juncture and in this context would not only cause the expenditure of tremendous time, effort and money on the part of the debtor in possession but would to a great extent frustrate the purposes to be served by Chapter XI and would inhibit the debtor's financial rehabilitation. Confronted with such equities in favor of the debtor, the temporary stay should be continued in full force and effect pending the conclusion of an evidentiary hearing before the Bankruptcy Judge and a final determination of the issues raised.

CONCLUSION

THE ORDER OF JUDGE BRIEANT AFFIRMING THE ORDER OF JUDGE BABITT SHOULD BE REVERSED AND THE MATTER REMANDED FOR AN EVIDENTIARY HEARING, WITH THE TEMPORARY STAY CONTINUED IN EFFECT PENDING SUCH HEARING AND FINAL DETERMINATION.

Dated: New York, New York
March 12, 1974

Respectfully submitted,
Levin & Weintraub
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